OPENING STATEMENT OF
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SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON REFORMING CREDIT RATING AGENCIES:
THE COMMISSION'S NEED FOR STATUTORY AUTHORITY

TUESDAY, APRIL 12, 2005

Mr. Chairman, we meet for the third time in the last two years to explore the issue of regulating credit rating agencies. As I have regularly noted during our past examinations, entities like Moody's, Standard and Poor's, and Fitch have long published their views on the creditworthiness of the issuers of debt securities. The significance of these opinions has also greatly expanded in recent years as a result of increases in the number of issues and issuers, the globalization of our financial markets, and the introduction of complex financial products.

Although rating agencies received some scrutiny after the recent surge of corporate scandals, we have not yet mandated any substantive changes in their practices. One witness at one of our past hearings nevertheless noted that the agencies "played a significant role" in Enron's failure. Additionally, a Senate investigative report determined that the monitoring and review of Enron's finances "fell far below the careful efforts one would have expected from organizations whose ratings hold so much importance."

Outside Enron's auditor, the rating agencies probably had the greatest access to non-public information about the firm's complicated financial arrangements. Even with this data, the agencies exhibited a disappointing reliability in the accuracy of their coverage. In fact, the three existing Nationally Recognized Statistical Rating Organizations at the time of Enron's failure rated the company at investment grade until four days before its bankruptcy filing.

The failure of the nationally recognized agencies to lower their credit ratings in a timely manner in this case and other instances -- such as WorldCom's bankruptcy, New York City's debt crisis, Washington Public Power Supply System's default, and Orange County's collapse -- has resulted in great financial losses for many Americans who little understood the true credit risks of their investments.

This issue is therefore one on which we should focus our attention in the 109th Congress. During our past hearings, it has also become increasingly clear to me that while our capital markets and the ratings industry have evolved considerably in recent years the Commission's rules in this area have changed little, even though it has studied these issues for more than a decade. Additionally, the *Washington Post* late last year in a series of investigative reports on credit ratings concluded that although the agencies with national recognition are the "gatekeepers of capitalism" they have no "commensurate oversight or accountability."

The regulation of rating agencies, I believe, is ripe for examination and action. I know that the Securities and Exchange Commission agrees. Today's witness, Annette Nazareth, the Commission's Director of Market Regulation, has previously observed that while rating agencies have generally performed their work well for nearly a century, they have also missed some "colossal" failures in recent years. She has further described our debt markets as "the dark corner" of the securities industry. The time has come to shine some light into this dimly lit field.

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Accordingly, I was pleased that the Commission recently finally put forward for public comment a proposed rule to define what constitutes a Nationally Recognized Statistical Rating Organization and the process for making such a designation. While this proposal is a good step, more still needs to be done in the area of rating agency oversight.

The agencies, as I am aware, are also working with the Commission to establish a voluntary framework to improve transparency. While some hope that this agreement will be effective, many have lingering doubts. After all, Chairman Donaldson has already indicated that he does not have the confidence that these discussions will result in substantive reforms because the existing agencies with national recognition have taken the position that they will not allow the Commission to conduct inspections or take enforcement actions.

As you know, Mr. Chairman, top officials at the Commission have also regularly suggested that additional legislative authority may be needed in the area of rating agencies. Consequently, I have now come to conclude that it is time for us to ask the Commission what specific authorities it believes it needs to effectively oversee rating agencies. <u>I will therefore be sending a letter to the Commission after today's hearing to request this technical assistance</u>.

The Congress will ultimately decide whether to consider a bill related to these issues, but obtaining the insights of the experts at the Commission will help us in crafting an appropriately balanced piece of legislation that addresses First Amendment concerns. Learning of the Commission's views now on the needed statutory authority will also help us to expedite future action if the voluntary framework negotiations break down or result in a flawed product.

In closing, Mr. Chairman, we must act to ensure the continued integrity of the rating agencies and the credit rating process. I also look forward to hearing from our witness today and to moving forward prudently and promptly on these important matters.